RS650-2

JEI REPORT

JAPAN ECONOMIC INSTITUTE

No. 41A

October 22, 1982

JAPAN'S CONSUMER CREDIT MARKET

SUMMARY

This JEI Report investigates the growth, current status and potential development of the consumer credit industry in Japan. Because of the longer maturities and differing industry structure, housing mortgages are excluded from this report.

Japan's high rate of individual saving is the result of many factors, one of which is the underdeveloped state of consumer credit. In 1980, for example, the ratio of consumer credit outstanding (excluding mortgages) to personal disposable income was only 7.0 percent, compared with 21.7 percent in the United States -- sufficiently small that the market for consumer credit can be expected to grow substantially. Sales of consumer durables, including electric appliances and automobiles, which spurted during the high-growth period, provided the impetus for the development of consumer credit companies, supplementing the minor lenders who traditionally had catered almost exclusively to lower-income applicants. These small-scale businesses which are dependent on high-interest financial sources generally charge very high interest rates. Nevertheless, these outlets have grown along with bank card credit and other more sophisticated commercial institutions. At present, consumer credit companies are gradually cultivating demand from middle- and upper-income wage earners whose potential for expenditures is expected to have a large impact on the consumer credit market.

Historical Background

Until 1960, demand for consumer credit was met by installment sales, sales finance companies (Shinpan) and manufacturer-affiliated credit companies. Social resistance to the idea of consumer credit was strong, however, and a variety of legal restraints were introduced which interfered with the orderly extension of credit. The Shinpan finance companies, for instance, were prevented from issuing credit cards for use in nationwide department stores in order to protect regional retail stores. Despite these constraints, as sales of consumer durables, such as home electric appliances and automobiles boomed in the 1960s, retailers and manufacturer-affiliated credit companies moved quickly to

The JEI REPORT (ISSN 0744-6489) is published weekly for $40 per year by the Japan Economic Institute of America, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036. Second class postage paid at Washington, D.C. POSTMASTERS: Send address changes to JEI, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036.

expand installment sales. Banks instituted loans for consumer appliances and autos. The Japan Diner's Club and the Maruito consumer finance company were established, and in 1961 the Japan Credit Bureau shopping card was introduced.

By this time, households were able to purchase a wide range of products on credit to meet the needs of an increasingly affluent society. With some contraction in demand from the corporate sector in the 1965 recession, many other financial institutions entered the consumer finance market, and bank-affiliated card companies were established in the late 1960s. As demand for major consumer durables slowed in the 1970s when the process of diffusion was completed, pure cash loans provided by new consumer finance companies as well as by Shinpan expanded to take a larger share of the rapidly changing credit market. As the outstanding total of borrowings advanced, foreign-capital consumer finance companies entered the Japanese market, bringing with them more competitive rates and larger, more efficient marketing techniques.

Types of Consumer Credit

The increase in consumer credit in 1980 totaled ¥15.6 trillion (approximately $59 billion at current exchange rates) and amounted to 11.4 percent of personal consumption. The outstanding total has increased by an annual average rate of 17.3 percent since the first oil crisis in 1973, although the impact of that downturn has gradually slowed the growth of personal consumption. The structure of Japan's credit market can be seen in Table 1. Suppliers of credit are divided into companies which provide direct cash loans and those which offer other types of financing (sales credit). In 1980, suppliers of credit tied to specific purchases — department store cards, bank cards, retailer- and manufacturer-affiliated credit companies and general consumer credit institutions — accounted for 66.4 percent of the market, and other, general loans for 35.6 percent. Credit sales still have a high share in total consumer credit, but the ratio has been declining from its 70-percent range as the money-lending business has grown.

Installment sales, including retailer- and manufacturer-affiliated credits account for 87 percent of total sales credit. Bank-affiliated credit cards have not been competitive in this area as they do not offer installment payments. The principal trend has been the tremendous increase in the cash loan field since 1975, with the addition of more banks and other lenders boosting this portion of the consumer finance market at more than a 50-percent average annual rate.

Retail Credit — Although outlets specializing in installment sales grew rapidly at first and held more than a 40-percent share of all consumer credit in 1968, the development of the market has altered this concentration. With the oil crisis in 1973 and the resulting slump in the economy, increased competition emerged as large department stores began to offer installment sales and Shinpan and bank-affiliated credit cards began to tap the same market. Archaic credit procedures and high commissions also made it difficult for these traditional installment outlets to compete with other financing agencies entering the field. Gradually, some of these merged into affiliations with large retailers or department stores, or simply evolved into consumer finance operations.

Manufacturer-Affiliated Credit — A wide range of manufacturers of electric appliances and automobiles made credit available in order to sell relatively expensive consumer goods. In order to meet their liquidity needs as demand expanded, these firms then established affiliated credit companies to obtain funds from financial institutions. As a group, manufacturer-affiliated credit companies increased their share of the consumer credit market until 1972 when they reached 22.5 percent; by 1980 that had

dropped to 16.7 percent. This trend is expected to continue as demand for their products continues to stagnate and new entrants into the credit network seek a niche in the buying process. The largest of these firms have begun to diversify into other areas, such as factoring or overseas consumer credit.

Shinpan — These finance companies offer a wide range of consumer credit, available either through credit card purchases or consumer loans. If a user purchases goods with a credit card, Shinpan makes payment to the retailer and bills the consumer on an installment basis. Borrowers also have the option of cash loans, in which case a contract is issued. This mode is designed to expand the range of use of Shinpan credit, which operates under the restriction that holders cannot use their credit cards in nationwide department stores. Installment sales through Shinpan increased their share of the consumer market to 8.1 percent, and contracts sales to 16.1 percent in 1980. The same pattern is seen in Table 1, which shows all installment sales under contract are more popular than installment sales on credit cards. Anticipating new marketing trends, Shinpan companies have begun to diversify their activities into installment factoring, computer on-line systems for credit cards, and direct cash loans.

Credit Cards -- Credit cards are issued by bank-affiliated card companies, Shinpan, retailers and oil companies. Of these, bank-affiliated credit card companies have issued the largest number of cards and have the largest annual turnover. In their eagerness to enter this field, banks have made great efforts to acquire cardholders and increase their loan portfolios in the personal sector. However, since these cards have no installment provision, they have been less well received and consequently less profitable. Many financial institutions are diversifying their activities and aggressively pursuing the more promising cash loan market. Brisk activity has also begun in bank tie-ups with foreign firms, such as VISA International Service Association and Mastercard. These companies have extended franchises to city banks, mutual savings and loans and credit associations, and have offered joint international credit cards. These cards are extremely advantageous to the consumer because of the wide range of potential services they offer.

Banks — Consumer credit by city banks, local banks, mutual savings and loans and credit associations is available for retail purchases of automobiles, pianos, electric appliances, travel and furniture. Personal secured bank loans have been available since 1971. Unsecured personal loans were first offered by Sanwa Bank in 1978, principally in response to social pressure generated by the high interest rates charged by the small cash loan companies. Additionally, competition within the banking industry impelled the banks to find customers as demand from the corporate sector declined. And a portion of the market was already being developed by the postal savings system. Bank loans are more advantageous to borrowers and carry a lower interest rate. At the same time, since it is essential that they protect their depositors and maintain their asset level, these low-risk loans are confined to middle- and high-income classifications. In 1980, all personal loans amounted to only 9.7 percent of total consumer credit. The more important role in the consumer credit market is the banking industry's provision of funds to Shinpan, credit card companies, retail stores and other consumer credit institutions.

Consumer Finance Companies — The remaining portion of the consumer finance market is occupied by the numerous cash loan companies, which are still the most common form of financing. (Until 1960, pawnshops were very prominent in this category, but their popularity has declined). These cash loan companies are referred to as sara-kin because they are provided mainly to "salaried men." The "sara" is derived from salaried and "kin" implies finance. Such loans are convenient because they are not fixed to specific purchases or stores and no collateral is necessary. These companies are easily established simply by registering with the local government, and are frequently small and

under-capitalized. A survey done by the Ministry of Finance shows that 60 percent of these businesses had less than ¥5 million (approximately $9,000) in capital. Compared with banks and larger financial institutions, these firms borrow and lend at high interest rates. Requiring no security and with limited access to credit files, they incur high rates of default. Half of the borrowers use the cash for daily needs and often are unable to repay the loans.

The industry is not strictly regulated and consumer legislation has so far been absent. Under the Capital Subscription Law, an upper ceiling of 109.5 percent annual interest rate may be charged on direct cash loans. Typically, loans from small money-lenders are reported to average between 84 and 102 percent. The emergence of larger and more efficient companies is expected to be instrumental in bringing down this exorbitant interest rate. The very rapid rates of expansion and the high profitability potential have attracted a number of foreign-affiliated companies to the market (see Table 2), although recently, Japan Household Finance Corp. and BA Finance closed their Japanese offices, citing consumer resistance to strict credit investigations.

Current Policy Questions

Protection of Small Retailers -- The Ministry of International Trade and Industry (MITI) and the Ministry of Finance (MOF) have sporadically issued regulations as part of the government policy to protect small- and medium-scale retailers. Since 1959, MITI has restricted installment sales by department stores and prevented the use of Shinpan credit cards in department stores. An MOF regulation dating from 1975 restricts installment sales by bank-affiliated credit card companies for the same reason — i.e. the parent bank's resources are considered so large as to constitute unfair competition. In addition, banking institutions are prevented from offering revolving accounts. Thus although bank-affiliated credit cards were designed to supplement the undeveloped consumer credit business in that sector, legislative restraints have prevented their competing on an equal basis, and while the use of credit cards is rising, it is not as widespread as in the United States.

Interest-Rate Regulation — Revisions of the interest-rate regulations governing consumer lending are essential. As noted above, the main regulation of cash loan companies rests with local governments. However, two national laws govern lenders; one applicable to banks and the other to the general credit market. This legislation sets the upper interest ceiling on cash loans at 20 percent for banks and 109.5 percent for cash loan companies. This discrepancy has had serious repercussions on the participating firms and corrections of these built-in inequities remains an important matter.

Tax Treatment — Interest on consumer credit cannot be deducted from income taxes in Japan. The only exception is a limited tax preference for housing loans. A taxpayer whose yearly mortgage payments (interest and principal) exceed ¥300,000 (approximately $1,100) is entitled to deduct only 5 percent of that sum up to ¥30,000 (approximately $110) from taxes for three years; even this deduction is not allowed to individuals whose total income exceeds ¥8 million (approximately $30,000).

Personal Credit Investigation — A major concern for the industry has been the absence of a nationwide credit information system. With the emergence of new loan companies, the need for a readily accessible credit clearinghouse has become a major limitation. As shown in Table 3, there are five personal credit information centers in Japan, but because individual companies maintain their own files and do not divulge their information, these centers do not yet have enough data of the size and quality required by industry participants. Moreover, much of the credit information presently held only lists borrowers in default, rather than credit histories, and does not offer adequate data to the lender.

Potential for Increased Borrowing

Since consumer credit parallels personal consumption expenditures, economic growth can be expected to influence the level of consumption. According to the government's seven-year forecast, the average annual growth in consumer spending from 1979-85 is expected to drop to a nominal rate of 11 percent, from a 14-percent level in 1973-79. This, MITI's council on consumer credit suggests, will shrink the growth of the market for credit to an average annual rate of about 12 percent, as compared with the present 18 percent. The actual behavior of the market, however, refutes this direction. Despite a decline in the growth rate of consumer spending, consumer credit continues to expand. With a low ratio of consumer credit outstanding against personal disposable income, there is ample room for growth. Furthermore, with business activity stabilized and demands for loans from the corporate sector lagging, private financial institutions are more aggressively pursuing the consumer credit market. Because loan demand from middle- and upper-income borrowers has been very low, banking institutions anticipate the need to actively develop the potential of this market, by offering, for example, the convenience of credit cards with an international network of travel and shopping credit as an attractive incentive. Japan's consumer credit industry, now entering a period of innovation and expansion, is expected to continue at a strong pace.

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Table 1

Structure of Consumer Credit (New Credit Extensions)

(in billions of yen)

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Loans													
Post Office Savings Loans	¥ 0	¥ 0	¥ 0	¥ 0	¥ 0	¥ 153	¥ 200	¥ 240	¥ 323	¥ 391	¥ 439	¥ 480	¥ 684
						(3.0%)	(3.5%)	(3.3%)	(3.8%)	(4.0%)	(3.7%)	(3.4%)	(4.4%)
Pawnshop Financing	170	173	177	181	187	192	197	204	210	217	225	217	224
	(9.0%)	(6.9%)	(6.0%)	(5.6%)	(4.6%)	(3.8%)	(3.4%)	(2.8%)	(2.5%)	(2.2%)	(1.9%)	(1.6%)	(1.4%)
Personal Loans Guaranteed by Financial Institutions	174	333	437	454	499	567	452	578	628	651	853	856	894
	(9.2%)	(13.3%)	(14.9%)	(14.0%)	(12.3%)	(11.2%)	(7.9%)	(8.0%)	(7.5%)	(6.6%)	(7.3%)	(6.1%)	(5.7%)
Personal Loans Unguaranteed by Financial Institutions	105	129	155	174	229	389	373	526	622	706	840	902	622
	(5.6%)	(5.2%)	(5.3%)	(5.4%)	(5.7%)	(7.7%)	(6.5%)	(7.2%)	(7.4%)	(7.2%)	(7.1%)	(6.5%)	(4.0%)
Money Lending Business	4	6	8	12	84	143	206	342	534	881	1,312	2,077	2,802
	(0.2%)	(0.2%)	(0.3%)	(0.4%)	(2.1%)	(2.8%)	(3.6%)	(4.7%)	(6.3%)	(8.9%)	(11.2%)	(14.8%)	(18.0%)
Total Loans	453	641	777	820	999	1,444	1,428	1,890	2,317	2,846	3,669	4,525	5,226
	(24.0%)	(25.6%)	(26.5%)	(25.3%)	(24.7%)	(28.4%)	(24.9%)	(26.0%)	(27.5%)	(28.8%)	(2[illegible]2%)	(32.4%)	(33.6%)
Sales on Credit													
Bank-Affiliated Credit Cards	47	110	132	165	199	271	349	415	500	600	690	800	1,070
	(2.5%)	(4.4%)	(4.5%)	(5.1%)	(4.9%)	(5.3%)	(6.1%)	(5.7%)	(5.9%)	(6.1%)	(5.9%)	(5.7%)	(6.9%)
Department Store Credit Cards	---	---	---	---	122	154	185	203	222	236	272	313	245
					(3.0%)	(3.0%)	(3.2%)	(2.8%)	(2.6%)	(2.4%)	(2.3%)	(2.2%)	(1.6%)
Installment Sales Through Credit Cards	112	138	151	165	206	277	345	427	535	665	856	1,136	1,255
	(5.9%)	(5.5%)	(5.2%)	(5.1%)	(5.1%)	(5.5%)	(6.0%)	(5.9%)	(6.4%)	(6.7%)	(7.3%)	(8.1%)	(8.1%)
Installment Sales Contracts	---	11	19	33	66	133	230	424	620	915	1,269	1,837	2,508
		(0.4%)	(0.6%)	(1.0%)	(1.6%)	(2.6%)	(4.0%)	(5.8%)	(7.4%)	(9.3%)	(10.8%)	(13.1%)	(16.1%)
Other Retailers Credit	778	890	964	1,015	1,102	1,216	1,453	1,809	1,936	2,140	2,359	2,411	2,657
	(41.3%)	(35.6%)	(32.9%)	(31.3%)	(27.2%)	(24.0%)	(25.3%)	(24.9%)	(23.0%)	(21.7%)	(20.1%)	(17.3%)	(17.1%)
Other Manufacturer-Affiliated Credit	494	711	886	1,046	1,358	1,582	1,755	2,091	2,289	2,470	2,641	2,948	2,599
	(25.2%)	(28.4%)	(30.2%)	(32.2%)	(33.5%)	(31.2%)	(30.5%)	(28.8%)	(27.2%)	(25.0%)	(22.5%)	(21.1%)	(16.7%)
Total Sales on Credit	1,431	1,860	2,152	2,424	3,053	3,633	4,317	5,371	6,102	7,026	8,087	9,445	10,332
	(76.0%)	(74.4%)	(73.5%)	(74.7%)	(75.3%)	(71.6%)	(75.1%)	(74.0%)	(72.5%)	(71.2%)	(68.8%)	(67.6%)	(66.4%)
Total Consumer Credit	1,884	2,501	2,929	3,244	4,052	5,077	5,745	7,261	8,419	9,872	11,756	13,970	15,558
	(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)

Note: Figures in parentheses are percentage distribution.

Source: Japan Installment Association

Table 2

List of Major Foreign Consumer Finance Companies

Consumer Finance Company	Date of Entry to Japan	Parent Company or Shareholder
Avco Financial Services of Japan, Inc.	July 1977	Avco Financial Services Inc.
Japan Hawaii Finance K.K.	April 1978	Hawaii Thrift & Loan Inc.
Japan Security Pacific Finance Co., Ltd.	August 1978	Security Pacific Credit Ltd.
Japan Household Finance Corp.	September 1978	Household Finance Corp.
Citicorp Credit Services, Inc.	April 1979	Citicorp Custom Credit Inc.
Japan Associates Financial Services	May 1979	Associates Corp. of North America
B.A. Finance (Japan) Ltd.	March 1980	Bank of America (Hong Kong)

Source: Ministry of Finance

Table 3

Personal Credit Information Centers in Japan

Credit Information Centers	Leading Members	Individual Data Records Compiled (in thousands)
Credit Information Center of Japan Installment Credit Association	Retailers and Finance Companies	13,500
Japan Credit Information Center	Manufacturer-Affiliated Credit Companies	3,000
Personal Credit Information Center of Bank Association	Financial Institutions and Credit Card Companies	2,000
National Credit Information Corporate Center	Consumer Finance Companies	4,000
Central Communication Bureau	Foreign-Capital Consumer Finance Companies	50

Source: Ministry of International Trade and Industry